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EXPLORING WITH
ENERGY AND EXPERIENCE

MIDNIGHT
Oil Exploration Ltd.



MIDNIGHT OIL EXPLORATION LTD. IS AN EXCITING HIGH GROWTH JUNIOR OIL AND GAS EXPLORATION COMPANY OPERATING IN SELECTED MULTI-ZONE HIGH POTENTIAL AREAS OF THE WESTERN CANADIAN SEDIMENTARY BASIN – INCLUDING RED EARTH, PEACE RIVER ARCH AND WEST CENTRAL ALBERTA.

MIDNIGHT IS A PROVEN EXPLORER THAT EMPLOYS A TALENTED HIGH-END TECHNICAL TEAM WITH STRONG BUSINESS EXECUTION SKILLS THAT PROVIDES A COMPETITIVE EDGE IN OUR AREAS OF OPERATION. MIDNIGHT'S INVESTMENT STRATEGY IS DRIVEN BY A RISK-BALANCED PORTFOLIO OF HIGH POTENTIAL EXPLORATION AND DEVELOPMENT PROSPECTS AND STRATEGIC ACQUISITIONS THAT TARGETS GROWTH TO OUR SHAREHOLDERS.

ANNUAL GENERAL MEETING

Midnight Oil Exploration's Annual General Meeting for its Shareholders is scheduled for 9:00am on Friday, May 12, 2006 at The Metropolitan Conference Centre 333 – 4th Avenue SW Calgary, Alberta.

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To learn more about Midnight Oil and Gas Ltd. please visit our website at www.midnightoil.ca

FINANCIAL AND OPERATIONAL HIGHLIGHTS

Financial (000's except per share amounts)	Q4 2005	Q3 2005	% Change	Periods ended December 31	
	2005	2004		2005	2004
Petroleum and natural gas sales	\$ 8,772	\$ 5,997	46	\$ 22,989	\$ 977
Funds from operations	\$ 4,991	\$ 3,073	62	\$ 11,967	\$397
Per share – Basic	0.16	0.12	37	0.44	0.02
– Diluted	0.16	0.12	35	0.43	0.02
Net income	\$ 864	\$ 487	77	\$ 1,669	\$ 15
Per share – Basic	0.03	0.02	42	0.06	0.00
– Diluted	0.03	0.02	40	0.06	0.00
Additions to capital assets	\$ 55,285	\$ 8,175	576	\$ 76,507	\$ 2,680
Net debt	16,730	11,344	47	16,730	(2,902)
Shares outstanding					
Basic	38,328	26,328	46	38,328	26,328
Diluted	41,511	29,360	41	41,511	28,661
Operations					
Average daily production					
Natural gas (mcf/d)	4,694	4,885	(4)	4,666	3,549
NGLs & crude oil (bbls/d)	600	270	122	326	132
Combined (boe/d)	1,382	1,084	27	1,104	723
Average prices received					
Natural gas (\$/mcf)	\$ 11.73	\$ 9.70	21	\$ 9.07	\$ 7.00
NGLs & crude oil (\$/bbl)	66.19	64.97	2	62.35	50.75
Combined (\$/boe)	\$ 69.02	\$ 60.13	15	\$ 57.04	\$ 43.58
Royalties	17.09	16.82	2	14.77	9.40
Operating expenses	8.22	9.05	(9)	9.17	11.14
Transportation expenses	0.03	0.05	(45)	0.03	0.00
Netback received (\$/boe)	\$ 43.68	\$ 34.21	28	\$ 33.07	\$ 23.04

PRESIDENT'S MESSAGE

"Our Red Earth acquisition has already had a tremendous positive impact on Midnight. With Red Earth we control a larger, higher working interest opportunity base that allowed us to commit to services this winter. It enabled Midnight to initiate a larger overall drilling program and provided Midnight the critical mass to participate for larger working interests in our high potential gas prospects," stated Fred Woods, President of Midnight. "Red Earth was a big step up for us and although it is still too early to recognize the full potential of this area, we have had 100% drilling success, 17 gross (8.8 net) wells and expanded the prospect base. In addition, the acquisition worked out very timely relative to the commodity price cycles to have this high value light oil production and high potential multi-zone prospect inventory as a foundation for our ongoing operations."

FOURTH QUARTER HIGHLIGHTS

During the quarter Midnight pursued an active and successful drilling program generating production growth and delivering solid financial results highlighted as follows:

- Acquired a high potential multi-zone light oil property in the Red Earth area for \$47.7 million.
 - Including over 35 net drilling locations and 67,700 net undeveloped acres.
- Fourth quarter drilling success rate of 100 percent on 17 gross (4.5 net) wells.
 - Red Earth drilling added 8 gross (3.8 net) oil wells.
- Fourth quarter production of 1,382 boe/d increased 27% from the third quarter.
 - December production averaged 1,973 boe/d up 173% from December 2004.
- Fourth quarter funds from operations increased 62% from the third quarter to \$5.0 million (\$0.16 per diluted share).
 - Funds from operations increased to \$12 million (\$0.43 per diluted share) in 2005 from \$0.4 million in 2004.
- Earnings increased 77% to \$0.9 million (\$0.03 per diluted share) in the fourth quarter versus the prior quarter.
 - Earnings increased to \$1.7 million (\$0.06 per diluted share) in 2005 from \$15 thousand in 2004.

On October 6, 2005, Midnight closed a private placement of 12,000,000 subscription receipts at a price of \$4.00 per subscription receipt for aggregate proceeds of \$48 million to finance the acquisition of the Red Earth properties.

RED EARTH ACQUISITION EXPANDS PROSPECT INVENTORY AND OPERATIONAL CONTROL

The Red Earth acquisition provided Midnight with an inventory of high potential light oil projects that allowed us to commit to drilling rigs and oilfield services this winter. It gave Midnight the critical mass to initiate a larger overall drilling program and to participate for larger working interests in our high potential gas prospects. The Red Earth acquisition brings high value light oil production and high

potential light oil growth opportunities to Midnight. Red Earth was a big step up for Midnight - we acquired Red Earth late in the year (closed November 30) with a relatively small reserve and production base and a lot of potential. We recognized that there would be a higher short term finding cost impact but we have already enjoyed excellent drilling results that have expanded our multi-year drilling inventory in this area and added significant upside potential. Although it is still too early to recognize the full potential of this acquisition so far we have had 100% drilling success, 17 gross (8.8 net) wells and expanded the prospect base.

The fact that Red Earth production is high quality light oil has been very timely relative to the commodity price cycles. The strength of oil prices has offset the weakness in gas prices and as a result we will continue to grow our revenues and pursue this high value light oil production as a foundation for our ongoing operations augmented by selected high potential multi-zone prospect inventory. Significant as well through the success of this winter's drilling program and associated production growth, Midnight transitions from being 15% light oil and NGLs to 50% light oil and NGLs.

Midnight continued with its success during the quarter drilling 17 gross (4.5 net) wells ending the year with 100% success from 42 gross (10.8 net) wells. Red Earth, which was only acquired during the fourth quarter, accounted for 8 gross (3.8 net) wells. So far in the first quarter of 2006, we have drilled 9 gross (5.0 net) of our planned program at Red Earth. Based on this winter's results and looking forward, Red Earth provides the foundation for a more active higher working interest capital program as the Company pursues its light oil opportunities and the high potential multi-zone natural gas targets at Wapiti, Sheldon and its West Central area.

Midnight commenced operations in December 2004 with production averaging 723 boe/d for the month and has more than doubled production to exit 2005 at over 2,000 boe/d. For the fourth quarter of 2005, production averaged 1,382 boe/d up 27% from the preceding quarter. Throughout the first quarter of 2006, Red Earth's new production additions have been intermittently restricted by allowables. With Sheldon production now on stream, current production exceeds 2,500 boe/d with an incremental 700 boe/d tested and behind pipe plus additional potential production adds from our ongoing winter drilling and completion program.

Financially in the fourth quarter, the Company delivered solid growth over the prior quarter. Funds from operations rose 62% to \$5.0 million and 35% to \$0.16 per diluted share, while earnings increased 77% to \$0.9 million and 40% to \$0.03 per diluted share.

OPERATIONS

Based on our results to date and Midnight's large prospect inventory, we are well positioned for growth in 2006. This winter, Midnight has conducted a very active capital program consisting of a large drilling program, additional 3D seismic programs, land sale acquisitions, facilitates and infrastructure construction in Red Earth, Wapiti and Sheldon.

In Red Earth, Midnight grew its opportunity base and enhanced value through successfully drilling a number of new pool light oil discoveries, securing multiple farm-ins, and conducting several 3D seismic shoots to delineate additional high impact locations. In addition Midnight continues to invest in infrastructure to ensure it has control over its production base in this area.

In Wapiti, successful drilling and increases in our land position, through land sales and joint ventures, have added significant value. Midnight's high end technical team has solidified future drilling opportunities to pursue the sweet gas Cretaceous reservoirs.

Our new sweet gas property in Sheldon saw its first gas sales in March, 2006. Additional drilling and pipelining in Sheldon and North Sturgeon is planned for the second quarter of 2006. With Sheldon production on stream and fully operational in mid-March, total Company production increases to approximately 3,000 boe/d by the end of the first quarter of 2006.

Red Earth

With the closing of this acquisition on November 30, 2005, Midnight commenced an aggressive capital program including development and exploration drilling, 3D seismic, well tie-in and construction. This program has been conducted during the winter to develop and explore the multi-zone light oil reservoirs of the Keg River and Granite Wash. In addition, consistent with our business strategy, Midnight elected to participate in and acquire ownership in the oil and water handling facilities in the Red Earth area. Also during the first quarter, the Company will be participating in the construction of a gas gathering system throughout the Red Earth area.

During the fourth quarter the Company drilled 8 gross (3.8 net) wells with an overall success rate of 100%. Midnight will continue with its active drilling program on this property in the first half of 2006, targeting light oil from several prospective horizons. So far in the first quarter of 2006, 9 gross (5.0 net) wells have been drilled and cased as oil wells.

Midnight also participated in the shooting of four 3-D seismic programs over our large land base in Red Earth to identify additional potential in the Keg River and Granite Wash in this area. In addition, Midnight has acquired or has the right to acquire over 6,000 additional net acres through Crown sales or farm-ins it has arranged in this area.

Wapiti

At Wapiti, Midnight enjoyed a successful fourth quarter targeting the multi-zone potential of the Deep Basin. During the fourth quarter Midnight drilled one (0.5 net) well and has targeted two (1.3 net) follow-up wells for the balance of the winter. In the first quarter of 2006, Midnight has aggressively pursued Crown land sales to increase our prospect inventory. As a result, Midnight has added numerous high working interest drill ready follow-up locations and plans an active drilling program for the balance of the year.

Sheldon

At Sheldon, Midnight's shallow sweet gas exploration and infill development program is progressing with solid results and additional upside has been identified. During 2005, Midnight drilled two (100% working interest) gas wells and has plans to drill four (100% working interest) gas wells in the first half of 2006. Three of these wells have been tied in and add approximately 3.0 mmcf/d of natural gas production in mid-March 2006.

As previously planned, Midnight commenced construction of a large gas gathering system in this area to handle the sweet gas production resulting from our drilling program. This 20 kilometre system will provide a sales line from the area for Midnight's recent discoveries and additional drilling planned during 2006. This system became operational in mid-March 2006.

To the west at North Sturgeon, Midnight recently completed a new pool discovery (MOX 100%). Midnight has identified two additional locations targeting the same shallow natural gas pool and plans to drill both wells before breakup. Midnight plans to construct a gathering system with sales to commence early in the third quarter.

West Central Alberta

In the West Central area, Midnight's operations are joint with Daylight. We have a large prospective inventory covering high potential multi-zone gas prospects. In this area Midnight holds 15% of Midnight and Daylight's combined 17% working interest. We have a large inventory of prospects and ownership of related facilities. This area has provided Midnight with a sustainable low decline production base since inception.

At Fir/Pine, Midnight drilled 8 gross (0.3 net) gas wells in the fourth quarter. To date in 2006, Midnight has successfully drilled two multi-zone gross (0.2 net) gas wells.

In Pembina, an industry partner, that is active and successful in the Nisku reef program, has committed to the drilling of a joint exploration well (MOX 35%) on an anomaly identified on our lands. The operator is continuing to pursue well licensing of this sour well.

OUTLOOK

Entering 2006, Midnight continues its aggressive drilling program throughout its core areas of Red Earth, Wapiti, Sheldon and West Central Alberta. The success of this program over the winter and through the first quarter provides us with our targeted higher production base from which we will continue to grow. Delineation drilling will continue on our Red Earth area focused on light sweet oil and at Wapiti targeting the multi-zone potential of this Deep Basin gas area.

Midnight is forecasting 2006 average production of 3,400 to 3,700 boe/d balanced between high value light oil and liquids rich natural gas production. For 2006, Midnight is forecasting capital expenditures of \$45 to \$55 million. The Company's 2006 capital expenditure program will allow Midnight to participate in approximately 31 gross (16.7 net) wells.

Midnight will be pursuing a risk balanced high potential drilling program with our light oil drilling at Red Earth and sweet gas drilling in the Peace River Arch at Wapiti and Sheldon. An exciting upside to our drilling program in 2006 will be several higher impact prospects in Wapiti, Beaverlodge and Pembina areas. This high-risk high-return program represents approximately 10% of Midnight's budget and with the addition of Red Earth can be pursued as part of a larger portfolio. Midnight has a large multi-year prospect inventory with 354,200 gross (186,400 net) undeveloped acres and is well positioned within its key strategic core areas of Red Earth, Wapiti, and West Central.

The Midnight team is committed to creating value for our shareholders. We have made great strides in building a solid asset base and have expanded our opportunity portfolio, balancing our product mix and growing our prospect inventory. I look forward to updating you on our progress throughout 2006.

Respectfully submitted on behalf of the Board of Directors,

Fred Woods

President & Chief Executive Officer
March 16, 2006

MANAGEMENT'S DISCUSSION AND ANALYSIS

Midnight Oil Exploration Ltd. ("Midnight" or the "Company") was incorporated on September 10, 2004 and commenced operations on November 29, 2004 under a Plan of Arrangement entered into by Midnight Oil & Gas Ltd. ("MOG") Daylight Energy Trust ("Daylight"), Daylight Acquisition Corp. and Midnight ("Plan of Arrangement"). Under the Plan of Arrangement, Daylight Acquisition Corp. acquired all the issued and outstanding shares of Vintage Petroleum Canada, Inc ("Vintage") along with the shares of MOG. As a part of the Plan of Arrangement certain assets of MOG and certain assets of Vintage were transferred to Midnight, and in return the shareholders of MOG and the subscription receipt holders of Daylight Acquisition Corp. obtained voting common shares of Midnight.

Midnight has been in operation for thirteen months. The comparative financial information presented includes the operating results of Midnight from the effective date of the Plan of Arrangement, November 30, 2004 to December 31, 2004. The following Management and Discussion Analysis will compare this stub period to the year ended December 31, 2005 but the focus will be on the variance between the fourth and third quarters of 2005.

The Management Discussion and Analysis for Midnight Oil Exploration Ltd. should be read in conjunction with the audited Consolidated Financial Statements and accompanying notes for the periods ended December 31, 2005 and 2004. Additional information relating to Midnight, including a detailed reserve analysis, will be included in our Annual Information Form, which may be found on SEDAR at www.sedar.com.

Basis of Presentation – The financial data presented below has been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). The reporting and the measurement currency is the Canadian dollar. For the purpose of calculating unit costs, natural gas is converted to a barrel equivalent ("boe") using six thousand cubic feet of natural gas equal to one barrel of oil unless otherwise stated.

Non-GAAP Measurements - Within the Management Discussion and Analysis references are made to terms commonly used in the oil and gas industry. Funds from operations, funds from operations per share and netbacks are not defined by GAAP in Canada and are referred to as non-GAAP measures. Funds from operations per share is calculated based on the weighted average number of common shares outstanding consistent with the calculation of net income per share. Netbacks equal total revenue less royalties, operating costs and transportation costs calculated on a boe basis. Management utilizes these measures to analyze operating performance and leverage. Funds from operations is commonly referred to as cash flow by research analysts and is used to value and compare oil and gas companies and is frequently included in published research when providing investment recommendations. Total boes are calculated by multiplying the daily production by the number of days in the period.

Forward Looking Statements - Certain statements contained within the Management Discussion and Analysis, and in certain documents incorporated by reference into this document, constitute forward-looking statements. These statements relate to future events or our future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "budget", "plan", "continue", "estimate", "expect", "forecast", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. We believe the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in, or incorporated by reference into, this Management Discussion and Analysis should not be unduly relied upon. These statements speak only as of the

date of this Management Discussion and Analysis or as of the date specified in the documents incorporated by reference into this Management Discussion and Analysis, as the case may be.

In particular, this Management Discussion and Analysis, and the documents incorporated by reference, contain forward-looking statements pertaining to the following:

- the performance characteristics of our oil and natural gas properties;
- oil and natural gas production levels;
- the size of the oil and natural gas reserves;
- projections of market prices and costs;
- supply and demand for oil and natural gas;
- expectations regarding the ability to raise capital and to continually add to reserves through acquisitions and development;
- treatment under governmental regulatory regimes and tax laws; and
- capital expenditures programs.

The actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this Management Discussion and Analysis:

- volatility in market prices for oil and natural gas;
- liabilities inherent in oil and natural gas operations;
- uncertainties associated with estimating oil and natural gas reserves;
- competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel;
- incorrect assessments of the value of acquisitions;
- geological, technical, drilling and processing problems;
- changes in income tax laws or changes in tax laws and incentive programs relating to the oil and gas industry and income trusts; and
- the other factors discussed under "Risks and Uncertainties".

Statements relating to "reserves" or "resources" are deemed to be forward looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the resources and reserves described can be profitably produced in the future. Readers are cautioned that the foregoing lists of factors are not exhaustive. The forward looking statements contained in this Management Discussion and Analysis and the documents incorporated by reference herein are expressly qualified by this cautionary statement. We do not undertake any obligation to publicly update or revise any forward-looking statements.

This Management Discussion and Analysis is dated as of March 15, 2006.

Business Objectives

Midnight targets to deliver above average growth and share price appreciation through execution of a well defined business strategy. To accomplish this, Midnight focuses on growing its production and reserves through a program of exploratory and development drilling and strategic acquisitions within its core project areas in the Western Canadian Sedimentary Basin. Midnight uses selected strategic acquisitions to capitalize and/or support drilling success with added lands or facility ownership as well to expand into new areas to establish a foothold and put in place the critical mass to support a sustainable exploration and development program.

The Company is focused on drilling exploration and development prospects in its new, light oil, core area in Red Earth and its large prospect inventory in the Peace River Arch and West Central Alberta. Midnight also evaluates and executes selected value added strategic acquisitions that meet its business objectives. The Red Earth property acquisition completed on November 29, 2005

follows a model the Midnight team has used repeatedly in the past with very successful results. There are two components – first a solid, high-quality, production base and secondly a large inventory of multi-zone, high-potential exploration prospects to expand and grow the production base. This acquisition matches Midnight's proven technical skills to a tremendous opportunity portfolio covering a large and focused undeveloped land base. We have conducted an extensive geo-technical analysis and, integrated with our existing seismic, have identified a multi-year, high potential prospect inventory targeting the prolific Keg River and Granite Wash reservoirs.

Midnight is a grass roots exploration and development company that internally generates opportunities in certain high-potential multi-zone areas in the deeper part of the Western Canadian Sedimentary Basin. The Company strives to maintain a risk balance between exploration, development and exploitation projects combined with strategic acquisition opportunities that meet Midnight's business parameters. Midnight has an Administrative and Technical Services Agreement with Daylight that provides for the sharing of certain personnel and services including drilling and field operations. Midnight, or Daylight on its behalf, aims to operate its activities as it believes that controlling the timing and costs of its projects wherever possible is essential to achieve its objectives. Further, to maintain cost control and reasonable access to facilities within its geographic areas of interest, Midnight strives to establish and optimize its working interest ownership in facilities and infrastructure where reasonably possible.

In reviewing potential drilling or acquisition opportunities, Midnight utilizes the proven technical expertise and business execution skills of its team to focus in technically demanding high-potential multi-zone areas. Our methodology uses a ranking or prioritizing of opportunities based on available capital, resources and timing and gives consideration to the following criteria:

- risk capital required to secure or evaluate the investment opportunity;
- potential return on the project, if successful;
- likelihood of success; and
- risked return versus cost of capital.

In general, Midnight targets to build and exploit a competitive edge based upon its proven technical expertise and use a portfolio approach in developing a large number of opportunities with a balance of risk profiles in an attempt to generate sustainable high levels of profitable production and financial growth.

Creation of Midnight and the Red Earth Acquisition

Under the Plan of Arrangement, made effective on November 30, 2004, certain assets of MOG and Vintage were transferred to Midnight. The MOG shareholders along with the Daylight Energy Trust Series U subscription receipt holders effectively received 0.50 of a voting share of Midnight for every common share of MOG and for every Series U subscription receipt of Daylight Energy Trust.

The conveyed assets included petroleum and natural gas properties that produced approximately 700 boe/d at closing comprised of 15% of Vintage's interest in its properties in West Central Alberta (the "Pine Creek Block"), and 142,000 acres of undeveloped land in West Central Alberta and Peace River Arch areas. In addition, Midnight has an option to farm-in on approximately 20,000 net acres of former Vintage exploratory lands retained by Daylight on standard industry terms, thereby providing Midnight with an additional portfolio of opportunities.

On November 29, 2005, Midnight closed the acquisition of certain assets located in the Red Earth area for a total acquisition cost, payable in cash, of \$47.66 million. The acquisition was completed in connection with Daylight's corporate acquisition of Tempest Energy Corp. The Red Earth assets included 1.8 million boe of high quality, long life oil and natural gas reserves on a proven plus

probable basis, 67,700 net acres of undeveloped land, 144 square kilometers of 3D seismic and production of approximately 850 boe/d after taking into consideration maximum rate limitations (“MRLs”). From

October 1, 2005 (the effective date) to November 29, 2005 (the closing date), 4 gross (2.8 net) successful oil wells were drilled and production increased from 650 boe/d to the 850 boe/d level. Midnight commenced an active drilling program on these lands drilling 8 wells in the 4th quarter of 2005. A Business Acquisition Report on this transaction dated February 10, 2006 has been filed on SEDAR at www.sedar.com.

Relationship with Daylight Energy Trust (“Daylight”)

In conjunction with the Plan of Arrangement completed on November 30, 2004, Midnight and Daylight entered into an Administrative and Technical Services Agreement which provides for the sharing of services required to manage Midnight’s activities and govern the allocation of general and administration expenses between the entities. Under this agreement, Daylight is the employer on behalf of the parties and receives payment for certain technical and administrative services provided to Midnight on a cost recovery basis. The Administrative Technical Services Agreement has no set termination date and will continue until terminated by either party with three months written notice to the other party. Both Midnight and Daylight have established independent Corporate Governance committees within their respective Boards of Directors to monitor compliance with the Administrative and Technical Services Agreement.

Selected Quarterly and Annual Information

Financial (000's, except for per share amounts)	2005				2005 Year	2004 Q4 ⁽¹⁾
	Q4	Q3	Q2	Q1		
Petroleum and natural gas sales	\$ 8,772	\$ 5,997	\$ 5,050	\$ 3,170	\$ 22,989	\$ 977
Royalties	2,172	1,678	1,401	702	5,953	211
Operating expenses	1,044	902	969	782	3,697	249
Transportation expenses	3	5	-	3	11	1
Net backs	\$ 5,553	\$ 3,412	\$ 2,680	\$ 1,683	\$ 13,328	\$ 516
General and administration	491	278	292	141	1,202	126
Net interest (income)	(68)	58	4	(18)	(24)	(12)
Abandonment expenditures	51	3	10	31	95	5
Capital tax	88	-	-	-	88	-
Funds from operations	\$ 4,991	\$ 3,073	\$ 2,374	\$ 1,529	\$ 11,967	\$ 397
Per share – Basic	0.16	0.12	0.09	0.06	0.44	0.02
– Diluted	0.16	0.12	0.09	0.06	0.43	0.02
Net income	\$ 864	\$ 487	\$ 158	\$ 160	\$ 1,669	\$ 15
Per share – Basic	0.03	0.02	0.01	0.01	0.06	0.00
– Diluted	0.03	0.02	0.01	0.01	0.06	0.00
Additions to capital assets	\$ 55,285	\$ 8,175	\$ 4,482	\$ 8,565	\$ 76,507	\$ 2,680
Net debt	16,730	11,344	6,242	4,134	16,730	(2,902)
Total assets	111,171	54,187	47,350	45,106	111,171	42,120
Shares outstanding						
Basic	38,328	26,328	26,328	26,328	38,328	26,328
Diluted	41,511	29,360	29,393	28,821	41,511	28,661
Operations						
Average daily production						
Natural gas (mcf/d)	4,694	4,885	5,151	3,924	4,666	3,549
NGLs & crude oil (bbls/d)	600	270	297	135	326	132
Combined (boe/d)	1,382	1,084	1,156	788	1,104	723
Average prices received						
Natural gas (\$/mcf)	\$ 11.73	\$ 9.70	\$ 7.62	\$ 6.92	\$ 9.07	\$ 7.00
NGLs & crude oil (\$/bbl)	66.19	64.97	53.64	58.96	62.35	50.75
Combined (\$/boe)	\$ 69.02	\$ 60.13	\$ 48.01	\$ 44.68	\$ 57.04	\$ 43.58
Royalties	17.09	16.82	13.33	9.89	14.77	9.40
Operating expenses	8.22	9.05	9.20	11.03	9.17	11.14
Transportation expenses	0.03	0.05	-	0.04	0.03	-
Netback received (\$/boe)	\$ 43.68	\$ 34.21	\$ 25.48	\$ 23.72	\$ 33.07	\$ 23.04

(1) 2004 is for the period of November 29, 2004 to December 31, 2004 and therefore represents both the fourth quarter and the results for the period ended December 31, 2004.

Petroleum and Natural Gas Sales

Petroleum and natural gas sales totaled \$22,989,000 for the year ended December 31, 2005 derived from production of 1,104 boe/d with a \$57.04 realized sales price. The 2004 petroleum and natural gas sales represent only one month of operations. Of the \$22 million increase in sales over the year, \$16.6 million relates to production with a 53% increase in volumes and eleven more months of production the balance of \$5.4 million relates to the higher realized prices.

Midnight's initial production was comprised of the assets acquired through the Plan of Arrangement. During the year ended December 31, 2005, 656 boe/d or 59% of production was from these assets, focused in the West Central area of Alberta, with the remaining 510 boe/d or 41% coming from new production, focused in the Peace River Arch area, and the acquired properties in Red Earth.

Natural gas production for the fourth quarter declined 4% versus the third quarter and natural gas liquids declined 60 bbls/d from the third quarter as a result of reaching early payout of a liquids rich natural gas well in the Peace River Arch area. Midnight has recognized net revenue and production volumes from the Red Earth assets since the closing date of November 29, 2005. As a result, this acquisition added 910 bbls/d of oil for the month of December but only 303 bbls/d of production to the fourth quarter to average 470 bbls/d. As this acquisition is oil based, the product mix for Midnight has changed to 50% light quality crude oil, 44% natural gas and 6% natural gas liquids for the month of December 2005. The product mix for the third quarter was 75% natural gas, 18% natural gas liquids and 7% light quality crude oil.

The following tables outline our production sales, volumes, and average sales price for the periods indicated below:

Petroleum and Natural Gas Sales (000's)	Q4	Q3	Periods ended December 31	
	2005	2005	2005	2004
Natural Gas	\$ 5,065	\$ 4,360	\$ 15,443	\$ 770
Oil	2,939	560	4,164	89
Liquids	709	1,055	3,263	118
Royalty income	59	22	119	-
Total	\$ 8,772	\$ 5,997	\$ 22,989	\$ 977

Production	Q4	Q3	Periods ended December 31	
	2005	2005	2005	2004
Natural Gas (mcf/d)	4,694	4,885	4,666	3,549
Oil (bbls/d)	470	80	166	55
Liquids (bbls/d)	130	190	160	77
Total (boe/d)	1,382	1,084	1,104	723

Prices and Marketing	Q4	Q3	Periods ended December 31	
	2005	2005	2005	2004
Benchmark Prices				
Alberta spot (\$/mcf)	\$ 11.46	\$ 9.24	\$ 8.65	\$ 6.73
WTI oil (\$US/bbl)	60.02	63.18	56.59	43.23
Cdn/US average exchange rate	0.8522	0.8322	0.8261	0.8213
Edmonton Par (\$Cdn/bbl)	\$ 71.40	\$ 76.96	\$ 69.18	\$ 51.31
Midnight's Average Selling Price				
Natural gas (\$/mcf)	\$ 11.73	\$ 9.70	\$ 9.07	\$ 7.00
Crude oil (\$/bbl)	68.02	76.07	68.68	52.10
NGLs (\$/bbl)	59.52	60.30	55.79	49.76
Combined oil & NGLs (\$/bbl)	66.19	64.97	62.35	50.75
Total (\$/boe)	\$ 69.02	\$ 60.13	\$ 57.04	\$ 43.58

Midnight markets its natural gas on a daily spot market basis at various delivery points in Alberta and therefore the average Alberta spot market price in Canadian dollars per mcf is an appropriate

benchmark for our gas. We continue to receive a slight premium to the Alberta spot price for our gas sales and expect our future realized price to coincide with the Alberta spot price. Our NGL price has decreased as a percentage of the reference price as our liquids production includes more ethane which sells at a larger discount to the reference price. This shift in production mix has decreased our realized price for NGLs to approximately 84% of Edmonton Par. Our crude oil tracks closely to Edmonton Par. The Edmonton Par for the month of December averaged \$67.53/bbl versus the quarter average of \$71.40/bbl; as a large portion of our oil was derived from the Red Earth acquisition in the month of December our average realized oil price for the quarter of \$68.02/bbl tracks closely to the December month Edmonton Par average.

Midnight did not buy or sell any commodity or currency hedges during the period.

Royalties

Royalty payments are made to the owners of the mineral rights on our leases which include provincial governments (Crown) and freehold landowners as well as to other third parties by way of contractual overriding royalties.

In Alberta, royalties on natural gas and NGLs are charged by the government based on an established monthly Reference Price. The Reference Price is meant to reflect the average price for gas and NGLs in Alberta. Gas cost allowance, custom processing credits, and other incentive programs reduce the effective royalty rate.

Oil royalty rates are generally a function of production rates on a per well basis, prices and are also subject to certain reductions and incentives. Crown royalties in Alberta are generally satisfied by delivering the required amount of oil to the Crown.

Royalties (000's)	Q4		Periods ended December 31	
	2005	2005	2005	2004
Crown	\$ 2,083	\$ 1,473	\$ 5,484	\$ 192
Gross overriding	232	310	897	19
ARTC	(143)	(105)	(428)	-
Total	\$ 2,172	\$ 1,678	\$ 5,953	\$ 211
Total (\$/boe)	\$ 17.09	\$ 16.82	\$ 14.77	\$ 9.40
Total (% of revenue)	24.8%	28.0%	25.9%	21.6%

Royalties for the year ended December 31, 2005 totaled \$5,953,000 and for the three months ended December 31, 2005 totaled \$2,172,000. Q4 royalties represent 24.8% of revenues or \$17.09 per boe. Consistent with the previous quarter guidance, our royalty rate has decreased from 28% of revenue to 24.8% of revenue as gross overrides were converted to working interest. Gross overriding royalties account for 11% of our fourth quarter royalties compared to 19% of our third quarter royalties. During the year ended December 31, 2005, gas royalties averaged 29%, associated liquids averaged 30% and oil averaged 24% of associated product sales.

Operating Expenses

Operating expenses for the year ended and fourth quarter ended December 31, 2005 were within our guidance expectations. Operating expenses were \$9.17/boe for the year and \$8.22/boe for the fourth quarter. The reduction in operating expenses per boe was achieved from bringing on new lower cost production than our original asset base, supplemented with the operating expense reduction efforts of Daylight in the West Central area. We have experienced a reduction in operating expenses for every quarter since inception. The Red Earth area has higher operating expenses per boe than our existing base and therefore we expect our operating expenses to rise in

the first quarter of 2006 before they return closer to the \$9 per boe range when we bring on new natural gas production with lower operating costs.

Operating Expenses (000's)	Q4		Q3		Periods ended December 31	
	2005	2005	2005	2005	2004	
Operating expenses	\$ 1,044	\$ 902	\$ 3,697	\$ 249		
Total (\$/boe)	\$ 8.22	\$ 9.05	\$ 9.17	\$ 11.14		

Transportation Expenses

Transportation expenses are defined by the point of legal custody transfer of the commodity and are influenced by the nature of the production, location, availability of transportation and the sales point. The cost of delivering production to the custody transfer point is shown separately as transportation expense.

Midnight generally sells its light oil and NGLs production at the lease with the purchaser taking legal custody of the oil and paying a price for the oil at that delivery point. Natural gas is usually transported to an established delivery point such as AECO in Alberta and then delivered to the purchaser.

Transportation Expenses (000's)	Q4		Q3		Periods ended December 31	
	2005	2005	2005	2005	2004	
Transportation expenses	\$ 3	\$ 5	\$ 11	\$ 1		
\$ per boe	\$ 0.03	\$ 0.05	\$ 0.03	\$ 0.00		

Other Income- Interest Expense

Other income is comprised of interest income of \$211,000 for the year ended December 31, 2005. For the first quarter of 2005 we had a positive cash balance earning interest income of \$12,000 and during the fourth quarter we received interest income of \$181,000 from the deposit of our \$48 million of subscription receipts issued on October 6, 2005 which converted into shares on November 30, 2005. During the second quarter we drew on our bank lines and as a result incurred interest expense of \$187,000 for the year ended December 31, 2005. Our effective interest rate on our borrowings for the 2005 year averaged 4.2%; we expect this rate to increase slightly for 2006 with the corresponding increase in Bank of Canada rates.

General and Administration Expenses

During the year, net general and administration ("G&A") expenses totaled \$1,202,000 or \$2.98/boe and \$491,000 or \$3.86/boe for the fourth quarter ended December 31, 2005. Midnight's general and administration expenses have been allocated based on the Administrative and Technical Service Agreement with Daylight. This agreement enables Midnight to use the Daylight personnel to manage its operations. Through this agreement, Midnight is able to take advantage of Daylight's low overhead cost structure. Midnight is charged administration for its direct activities and for its proportionate share of overhead based on production and capital spending. Capitalized G&A is derived directly from the capital portion of the Administrative and Technical Service Agreement.

The components of general and administration expense are as follows:

General and Administration Expenses (000's)	Q4		Q3		Periods ended December 31	
	2005	2005	2005	2005	2004	
Direct G&A	\$ 195	\$ 90	\$ 448	\$ 106		
Technical service fee from Daylight	948	545	2,622	119		
Overhead recoveries from Daylight	(77)	(49)	(241)	-		
Capitalized G&A	(575)	(308)	(1,627)	(99)		
Net G&A	\$ 491	\$ 278	\$ 1,202	\$ 126		
Net G&A (\$/boe)	\$ 3.86	\$ 2.78	\$ 2.98	\$ 5.63		

For the three months ended December 31, 2005, net general and administration expenses on a boe basis increased to \$3.86/boe versus the previous quarter at \$2.78/boe. The overall allocation from the Administrative and Technical Agreement was higher as a result of our relative production levels and higher percentage of the total capital program. The \$105,000 increase in direct charges over the third quarter relates to normal year end legal and audit work and director fees associated with the Red Earth Acquisition.

Consistent with our past guidance, we met the annual net general and administration fee at the \$3/boe range for 2005. Midnight expects this charge to increase due to the higher proportionate share of Midnight's production and capital relative to the combined production and capital of both Midnight and Daylight.

Stock-Based Compensation

The Company applies the fair value method for valuing stock option grants and warrants. Under this method, compensation cost attributable to all share options granted and warrants issued are measured at fair value at the grant and issuance date and expensed over the vesting period with a corresponding increase to contributed surplus. Midnight recognized stock-based compensation expense of \$152,000 and \$449,000 for the three months and twelve months ended December 31, 2005 respectively. Midnight's unamortized portion of stock-based compensation is \$1,470,000, which will be expensed over the next three years.

Depletion, Depreciation and Accretion

For the year, depletion and depreciation of the petroleum and natural gas assets was \$8,409,000 compared to the one month period in 2004 of \$326,000. This represented a charge of \$20.87 on a per boe basis. For the fourth quarter, depletion and depreciation was \$3,399,000 versus the third quarter of \$1,965,000. The increase resulted from both higher production and from the Red Earth acquisition which added reserves at a cost of \$48.43 on a proved basis, including the associated land and seismic. On a boe basis, fourth quarter depletion and depreciation increased to \$26.74. Midnight expects to lower its depletion and depreciation rate on a per boe basis in 2006 as we exploit the acquired assets and add additional proved reserves.

The asset retirement cost included in petroleum and natural gas assets is depleted on a unit of production basis over the life of the reserves and the asset retirement obligations are accreted to their fair value with accretion expense recognized for each reporting period. As a result expenses related to asset retirement obligations are disclosed in both the depletion and depreciation and accretion expense. For the year, accretion expense totaled \$47,000 and \$13,000 for the fourth quarter. This is up from \$3,000 for 2004 and \$11,000 for the third quarter.

Taxes

For the year ended December 31, 2005, the future tax expense was \$1,488,000 resulting in an effective rate of 46%. The future tax expense for the three months ended December 31, 2005, was \$614,000 resulting in an effective tax rate of 39%. The difference in the expected rate of 37.6% and the effective rate is from permanent differences relating to stock-based compensation and the difference between non-deductible crown royalties and the resource allowance.

During the three months ended December 31, 2005, Midnight has recognized \$88,000 of capital tax expense. With the additional equity raised for the Red Earth acquisition, Midnight is subject to Large Corporation's Tax. Midnight does not expect to become taxable on an income tax basis in 2006. The Company has approximately \$102.5 million in tax pools to shelter taxable income in future years. The estimated tax pools are as follows:

Tax Pools (\$000's)	2005
Canadian exploration expense	\$ 15,400
Canadian development expense	7,900
Canadian oil and gas property expense	61,700
Undepreciated capital cost	14,500
Non-capital losses	500
Share issue costs	2,500
Total	\$ 102,500

Funds from Operations and Net Income

For the year ended December 31, 2005, funds from operations totaled \$11,967,000 or \$0.44 and \$0.43 per basic and diluted share respectively. Funds from operations totaled \$4,991,000 for the three months ended December 31, 2005 versus \$3,073,000 for the three months ended September 30, 2005 representing a 62% increase. On a per share basis funds from operations increased 35% from \$0.12 per diluted share to \$0.16 per diluted share from the third quarter to the fourth quarter of 2005. Net income for the three months ended December 31, 2005 totaled \$864,000 versus \$487,000 for the third quarter, and \$1,669,000 or \$0.06 per basic and diluted share for the 2005 year.

The following table summarizes the netbacks on a barrel of oil equivalent basis for the periods indicated:

(\$/boe)	Q4	Q3	Periods ended December 31	
	2005	2005	2005	2004
Sales price	\$ 69.02	\$ 60.13	\$ 57.04	\$ 43.58
Royalties	17.09	16.82	14.77	9.40
Operating expenses	8.22	9.05	9.17	11.14
Transportation expenses	0.03	0.05	0.03	0.00
Operating netback	\$ 43.68	\$ 34.21	\$ 33.07	\$ 23.04
General and administration	3.86	2.78	2.98	5.63
Interest (income)	(0.53)	0.57	(0.06)	(0.53)
Capital tax	0.69	-	0.22	-
Cash flow netback	\$ 39.66	\$ 30.86	\$ 29.93	\$ 17.94
Depletion, depreciation and accretion	26.84	19.82	20.98	14.70
Stock-based compensation	1.19	1.35	1.11	0.68
Future tax	4.83	4.80	3.70	1.89
Net income	\$ 6.80	\$ 4.89	\$ 4.14	\$ 0.67

Midnight's funds from operations are significantly influenced by production volumes and commodity prices. The fourth quarter represents the highest cash flow netback and net income per boe since inception leading to record funds from operations and net income for Midnight.

The following table provides a reconciliation to the change in funds from operations and net income for the three months ended December 31, 2005 compared to the three months ended September 30, 2005 and for the year ended December 31, 2005 to the period ended December 31, 2004.

Change in Funds from Operations and Net Income (000's)	Three months ended December 31, 2005		Year ended December 31, 2005	
	Funds from Operations	Net Income	Funds from Operations	Net Income
Beginning of period	\$ 3,073	\$ 487	\$ 397	\$ 15
Increase (decrease) in revenue:				
Change in production volumes	1,643	1,643	16,584	16,584
Change in prices	1,132	1,132	5,428	5,428
Change in royalties	(494)	(494)	(5,742)	(5,742)
Change in other income	181	181	199	199
(Increase) decrease in expenses:				
Operating	(142)	(142)	(3,448)	(3,448)
Transportation	2	2	(10)	(10)
Interest	(55)	(55)	(187)	(187)
General and administration	(213)	(213)	(1,076)	(1,076)
Stock-based compensation	-	(18)	-	(434)
Depletion, depreciation and accretion	-	(1,436)	-	(8,127)
Taxes	(88)	(223)	(88)	(1,533)
Abandonment expenditures	(48)	-	(90)	-
End of period	\$ 4,991	\$ 864	\$ 11,967	\$ 1,669

Capital Expenditures

For the year ended, December 31, 2005, Midnight invested \$76.5 million in its capital program including the acquisition of its Red Earth property for \$47.66 million. The Red Earth acquisition closed on November 29, 2005 and had an effective date of October 1, 2005. The acquisition was completed in connection with Daylight's corporate acquisition of Tempest Energy Corp. The acquisition included production at close of approximately 850 boe/d, a focused land base of 94,000 (67,700 net) undeveloped acres adjoining and surrounding existing production and over 144 square kilometers of 3-D seismic. The acquisition also provided multiple drilling locations that were the base of Midnight's winter drilling program. During the year ended 2005, Midnight drilled 42 (10.8 net) wells comprised of 32 (6.4) net natural gas wells and 10 (4.4 net) oil wells with a 100% success rate. During the fourth quarter of 2005 Midnight drilled 9 (0.8 net) natural gas wells and 8 (3.8 net) oil wells for a total of 17 (4.6 net) wells.

Capital Expenditures (000's)	Q4		Periods ended December 31	
	2005	2005	2005	2004
Land	\$ 291	\$ 615	\$ 3,564	\$ 72
Property acquisitions	47,666	-	47,666	-
Geological and geophysical	631	679	2,117	99
Drilling	3,882	3,308	13,241	1,594
Completions	1,927	2,638	7,001	261
Facilities pipelines and equipment	888	935	2,909	654
Petroleum and natural gas expenditures	\$55,285	\$ 8,175	\$76,498	\$ 2,680
Other fixed assets	-	-	9	-
Total expenditures	\$55,285	\$ 8,175	\$76,507	\$ 2,680

During the quarter, Midnight concentrated its drilling efforts on its Red Earth program; we drilled 8 (3.8 net) wells which accounted for 83% of Midnight's net wells drilled. The Red Earth wells also represents 35% of Midnight's total wells for the year ended 2005. Midnight has identified 35 to 45 drilling locations in the Red Earth area and in addition to the active fourth quarter we have a planned drilling program of 20 wells in 2006.

Midnight has undeveloped land at year end of approximately 186,400 net acres of which \$21.3 million or \$114 per acre has been excluded from the depletion calculation in the fourth quarter. We also have excluded \$3.6 million of undeveloped seismic from the depletion calculation in the fourth quarter. Over the next twelve months, 21 percent of Midnight's net undeveloped acreage will be subject to expiry. With an active drilling program, Midnight anticipates minimal undeveloped acres expiring in 2006.

Equity

The acquisition of the Red Earth properties was funded by an issuance of 12,000,000 subscription receipts at a price of \$4.00 per subscription receipt for gross proceeds of \$48 million. Each subscription receipt was converted into one common share of Midnight in accordance with their terms on November 30, 2005, the business day following the closing of the acquisition.

During the year ended 2005, Midnight granted 1,174,300 stock options to non-executive employees with an average exercise price of \$3.49 per share. Of these, 74,500 with a weighted average exercise price of \$3.30 were cancelled. The options vest equally over three years and expire five years from the date of grant. No options were exercisable at December 31, 2005. Midnight intends to limit option grants under its Stock Option Plan to 7.5% of the number of outstanding Midnight shares until December 1, 2006 at which time the number of options will be limited to 10% of the outstanding shares of Midnight.

As at March 15, 2006 the Company had outstanding 38,327,829 common shares, 1,084,300 stock options and 2,083,333 warrants.

Share Information (000's)	Q4		Periods ended December 31	
	2005	2005	2005	2004
Shares outstanding				
Basic	38,328	26,328	38,328	26,328
Diluted	41,511	29,360	41,511	28,661
Weighted average shares outstanding				
Basic	30,371	26,328	27,347	25,651
Diluted	30,862	26,738	27,696	25,804

Liquidity and Capital Resources

Midnight Oil Exploration Ltd. was listed as a senior issuer on the Toronto Stock Exchange on December 2, 2004 trading under the symbol "MOX". The Company's market capitalization at December 31, 2005 was \$169.4 million.

Trading History on the TSX	Q4	Q3	Periods ended December 31	
	2005	2005	2005	2004
High	\$4.85	\$4.59	\$4.98	\$4.20
Low	\$3.80	\$3.20	\$3.06	\$3.20
Close	\$4.42	\$4.40	\$4.42	\$3.40
Volume (000's)	3,725	6,871	25,427	6,559

In conjunction with the Red Earth acquisition, Midnight's current lenders increased Midnight's credit facility to \$20.0 million. At December 31, 2005, Midnight had drawn \$12.0 million on its credit facility and had a working capital deficit of \$4.8 million. Midnight's current credit facility is available by way of Canadian and US dollar prime rate based loans, bankers' acceptances, Libor borrowings and letters of credit. The facility is available on a revolving basis until June 30, 2006. On this date and at the Company's discretion, the facility is available on a non-revolving basis for a period of 366 days, at which time the facility would be due and payable. Alternatively, the facility may be extended for a further 364-day period at the request of the Company and subject to approval by the bank. The credit facility bears interest at the bank prime rate and is secured by a \$50 million first floating charge debenture and a general securities agreement.

Midnight anticipates that it will make substantial capital expenditures for the acquisition, exploration, development and production of petroleum and natural gas reserves in the future. To execute its 2006 capital program of \$45 to \$55 million, the Company will require additional debt or equity financing. Failure to obtain such financing on a timely basis could cause Midnight to delay its capital program and as a result potentially forfeit its interest in certain properties or miss certain acquisition opportunities. If Midnight's revenues from its production decrease as a result of lower oil and natural gas prices or otherwise, it will affect Midnight's ability to expend the necessary capital to replace its reserves or to maintain its production. If Midnight's funds from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on terms acceptable to Midnight.

Contractual Obligations

The contractual obligations for which the Company is responsible are as follows:

Contractual Obligations (000's)	Total	Less than		4-5 Years	After 5 Years
		1 Year	1-3 Years		
Technical service agreement	\$ 1,608	\$ 1,608	\$ -	\$ -	\$ -
Long-term debt	11,973	-	11,973	-	-
Asset retirement obligations	3,950	275	325	190	3,160
Total Contractual Obligations	\$ 17,531	\$ 1,883	\$ 12,298	\$ 190	\$ 3,160

Midnight enters into many contractual obligations in the course of conducting its day to day business. Material contract obligations consist only of our Administrative and Technical Service Agreement with Daylight and our long-term debt with a major bank. The payment terms on the asset retirement obligation is based on an estimated timing of expenditures to be made in future periods, actual expenditures and when they may occur may differ materially than presented above. Midnight has not entered into any firm transportation commitments to date.

Financial Instruments

Financial instruments comprise cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The fair values of these financial instruments approximate their carrying amounts due to their short-term maturities. The Company's long-term debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

Disclosure Controls and Procedures

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. Midnight's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by the annual filings, that the Company's disclosure controls and procedures for the year ended December 31, 2005 are effective to provide reasonable assurance that material information related to Midnight, including its consolidated subsidiaries, is made known to them by others within those entities. It should be noted that while Midnight's Chief Executive Officer and Chief Financial Officer believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

Application of Critical Accounting Estimates

The significant accounting policies used by Midnight are disclosed in note 1 to the audited Consolidated Financial Statements for the periods ended December 31, 2005 and 2004. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a regular basis. The emergence of new information and changed circumstance may result in actual results or changes to estimated amounts that differ materially from current estimates. The following discussion identifies the critical accounting policies and practices of the Company and helps assess the likelihood of materially different results being reported.

Reserves

Under the National Instrument 51-101 (NI 51-101) "Proved" reserves are defined as those reserves that can be estimated with a high degree of certainty to be recoverable. The level of certainty should result in at least a 90 percent probability that the quantities actually recovered will equal or exceed the estimated Proved reserves. It does not mean that there is a 90% probability that the Proved reserves will be recovered; it means there must be at least a 90% probability that the given amount or more will be recovered.

"Proved plus Probable" reserves are the most likely case and are based on a 50 percent certainty that they will equal or exceed the reserves estimated.

These oil and gas reserve estimates are made using all available geological and reservoir data, as well as historical production data. All of the Company's reserves were evaluated and reported on by an independent qualified reserves evaluator. However, revisions can occur as a result of various factors including: actual reservoir performance, changes in price and cost forecasts or a change in the Company's plans. Reserve changes will impact the financial results as reserves are used in the calculation of depletion and are used to assess whether asset impairment occurs. Reserve changes also affect other Non-GAAP measurements such as finding and development costs, recycle ratios and net asset value calculations.

Depletion

The Company follows the full cost method of accounting for oil and natural gas properties. Under this method, all costs related to the acquisition of, exploration for and development of oil and natural gas reserves are capitalized whether successful or not. Depletion of the capitalized oil and natural gas properties and depreciation of production equipment which includes estimated future development costs less estimated salvage values are calculated using the unit-of-production method, based on production volumes in relation to estimated proven reserves.

An increase in estimated proved reserves would result in a reduction in depletion expense. A decrease in estimated future development costs would also result in a reduction in depletion expense.

Unproved Properties

The cost of acquisition and evaluation of unproved properties are initially excluded from the depletion calculation. An impairment test is performed on these assets to determine whether the carrying value exceeds the fair value. Any excess in carrying value over fair value is an impairment. When proved reserves are assigned or a property is considered to be impaired, the cost of the property or the amount of the impairment will be added to the capitalized costs for the calculation of depletion.

Ceiling Test

The ceiling test is a cost recovery test intended to identify and measure potential impairment of assets. An impairment loss is recorded if the sum of the undiscounted cash flows expected from the production of the proved reserves and the lower of cost and market of unproved properties does not exceed the carrying values of the petroleum and natural gas assets. An impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost and market of unproved properties. The cash flows are estimated using the future product prices and costs and are discounted using the risk free rate. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material. Any impairment as a result of this ceiling test will be charged to operations as additional depletion and depreciation expense.

Asset Retirement Obligations

The Company records a liability for the fair value of legal obligations associated with the retirement of petroleum and natural gas assets. The liability is equal to the discounted fair value of the obligation in the period in which the asset is recorded with an equal offset to the carrying amount of the asset. The liability then accretes to its fair value with the passage of time and the accretion is recognized as an expense in the financial statements. The total amount of the asset retirement obligation is an estimate based on the Company's net ownership interest in all wells and facilities, the estimated costs to abandon and reclaim the wells and facilities and the estimated timing of the costs to be incurred in future periods. The total amount of the estimated cash flows required to settle the asset retirement obligation, the timing of those cash flows and the discount rate used to calculate the present value of those cash flows are all estimates subject to measurement uncertainty. Any change in these estimates would impact the asset retirement liability and the accretion expense.

Plan of Arrangement

As disclosed in Note 2 to the Consolidated Financial Statements, Midnight acquired assets from Vintage Petroleum Canada, Inc. and Midnight Oil & Gas Ltd. and accounted for these acquisitions using the purchase method based on fair values. The determination of fair value involves numerous estimates. The valuation of petroleum and natural gas assets is based on Midnight's estimate of

proved plus probable reserves using estimated forecasted prices at the time of acquisition, plus an estimation of unproved properties. Management also estimates the fair value of other assets and liabilities acquired on the acquisition. This valuation could differ materially by altering the various assumptions which would have impacted the composition of the balance sheet.

Income Taxes

The determination of income and other tax liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded by management.

Other Estimates

The accrual method of accounting requires management to incorporate certain estimates including estimates of revenues, royalties and operating costs as at a specific reporting date, but for which actual revenues and costs have not yet been received. In addition, estimates are made on capital projects which are in progress or recently completed where actual costs have not been received by the reporting date. The Company obtains the estimates from the individuals with the most knowledge of the activity and from all project documentation received. The estimates are reviewed for reasonableness and compared to past performance to assess the reliability of the estimates. Past estimates are compared to actual results in order to make informed decisions on future estimates.

New Accounting Standards

Financial Instruments – Recognition and Measurement

In April 2005, a series of new accounting standards were released which established guidance for the recognition and measurement of financial instruments. These new standards include Section 1530 "Comprehensive Income", Section 3855 "Financial Instruments – Recognition and Measurement", and Section 3865 "Hedges". The new standards also resulted in a number of consequential amendments to other accounting standards to accommodate the new sections. The standards require all applicable financial instruments to be classified into one of several categories including: financial assets and financial liabilities held for trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets, or other financial liabilities. The financial instruments are then included on a company's balance sheet and measured at fair value, cost or amortized cost, depending on the classification. Subsequent measurement and recognition of changes in value of the financial instruments also depends on the initial classification. These standards are effective for interim and annual financial statements for fiscal years beginning on or after October 1, 2006 and must be implemented simultaneously. Midnight anticipates adopting these standards on January 1, 2007. Midnight does not currently have any financial instruments that would be affected by these standards and therefore adoption of these standards will have no impact on the financial statements.

Risks and Uncertainties

Exploration, Development and Production Risks

Oil and natural gas exploration involves a high degree of risk, for which even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that expenditures made on future exploration by Midnight will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over-pressured zones, tools lost in

the hole and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretations thereof.

The long-term commercial success of Midnight will depend on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. No assurance can be given that Midnight will be able to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, Midnight may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic.

Future oil and gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

In addition, oil and gas operations are subject to the risks of exploration, development and production of oil and natural gas properties, including encountering unexpected formations or pressures, premature declines of reservoirs, blow-outs, cratering, sour gas releases, fires and spills. Losses resulting from the occurrence of any of these risks could have a materially adverse effect on future results of operations, liquidity and financial condition.

Prices, Markets and Marketing of Crude Oil and Natural Gas

Oil and natural gas are commodities whose prices are determined based on world demand, supply and other factors, all of which are beyond the control of Midnight. World prices for oil and natural gas have fluctuated widely in recent years. Any material decline in prices could result in a reduction of net production revenue. Certain wells or other projects may become uneconomic as a result of a decline in world oil prices and natural gas prices, leading to a reduction in the volume of Midnight's oil and gas reserves. Midnight might also elect not to produce from certain wells at lower prices. All of these factors could result in a material decrease in Midnight's future net production revenue, causing a reduction in its oil and gas acquisition and development activities. In addition, bank borrowings available to Midnight are expected to be determined in part by the borrowing base of Midnight. A sustained material decline in prices from historical average prices could limit Midnight's borrowing base, therefore reducing the bank credit available to Midnight, and could require that a portion of any existing bank debt of Midnight be repaid.

In addition to establishing markets for its oil and natural gas, Midnight must also successfully market its oil and natural gas to prospective buyers. The marketability and price of oil and natural gas which may be acquired or discovered by Midnight will be affected by numerous factors beyond its control. Midnight will be affected by the differential between the price paid by refiners for light quality oil and the grades of oil produced by Midnight. The ability of Midnight to market its natural gas may depend upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Midnight will also likely be affected by deliverability uncertainties related to the proximity of its reserves to pipelines and processing facilities and related to operational problems with such pipelines and facilities and extensive government regulation relating to price, taxes, royalties, land

tenure, allowable production, the export of oil and natural gas and many other aspects of the oil and natural gas business. Midnight has limited direct experience in the marketing of oil and natural gas.

Substantial Capital Requirements; Liquidity

Midnight's cash flow from its reserves may not be sufficient to fund its ongoing activities at all times. From time to time, Midnight may require additional financing in order to carry out its oil and gas acquisition, exploration and development activities. Failure to obtain such financing on a timely basis could cause Midnight to forfeit its interest in certain properties, miss certain acquisition opportunities and reduce or terminate its operations. If Midnight's revenues from its reserves decrease as a result of lower oil and natural gas prices or otherwise, it will affect Midnight's ability to expend the necessary capital to replace its reserves or to maintain its production. If Midnight's funds from operations is not sufficient to satisfy its capital expenditure requirements, there can be no assurance that additional debt or equity financing will be available to meet these requirements or available on terms acceptable to Midnight.

Midnight's lenders will be provided with security over substantially all of the assets of Midnight. If Midnight becomes unable to pay its debt service charges or otherwise commits an event of default, such as bankruptcy, these lenders may foreclose on or sell Midnight's properties. The proceeds of any such sale would be applied to satisfy amounts owed to Midnight's lenders and other creditors and only the remainder, if any, would be available to Midnight.

Insurance

Midnight's involvement in the exploration for and development of oil and gas properties may result in Midnight becoming subject to liability for pollution, blow-outs, property damage, personal injury or other hazards. Although Midnight has insurance in accordance with industry standards to address such risks, such insurance has limitations on liability that may not be sufficient to cover the full extent of such liabilities. In addition, such risks may not, in all circumstances be insurable or, in certain circumstances, Midnight may elect not to obtain insurance to deal with specific risks due to the high premiums associated with such insurance or other reasons. The payment of such uninsured liabilities would reduce the funds available to Midnight. The occurrence of a significant event that Midnight is not fully insured against, or the insolvency of the insurer of such event, could have a material adverse effect on Midnight's financial position, results of operations or prospects.

Competition

Midnight actively competes for reserve acquisitions, exploration leases, licenses and concessions and skilled industry personnel with a substantial number of other oil and gas companies, many of which have significantly greater financial and personnel resources than Midnight. Midnight's competitors include major integrated oil and natural gas companies and numerous other independent oil and natural gas companies and individual producers and operators.

Certain of Midnight's customers and potential customers are themselves exploring for oil and natural gas, and the results of such exploration efforts could affect Midnight's ability to sell or supply oil or gas to these customers in the future. Midnight's ability to successfully bid on and acquire additional property rights, to discover reserves, to participate in drilling opportunities and to identify and enter into commercial arrangements with customers will be dependent upon developing and maintaining close working relationships with its future industry partners and joint operators and its ability to select and evaluate suitable properties and to consummate transactions in a highly competitive environment.

Environmental Risks

All phases of the oil and natural gas business present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of international conventions and state and/or provincial and municipal laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can require significant expenditures and a breach may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to foreign governments and third parties and may require Midnight to incur costs to remedy such discharge. No assurance can be given that environmental laws will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise adversely affect Midnight's financial condition, results of operations or prospects.

Reserve Replacement

Midnight's future oil and natural gas reserves, production, and cash flows to be derived therefrom are highly dependent on Midnight successfully acquiring or discovering new reserves. Without the continual addition of new reserves, any existing reserves Midnight may have at any particular time and the production therefrom will decline over time as such existing reserves are exploited. A future increase in Midnight's reserves will depend not only on Midnight's ability to develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. There can be no assurance that Midnight's future exploration and development efforts will result in the discovery and development of additional commercial accumulations of oil and natural gas.

Reliance on Operators and Key Employees

Pursuant to the terms of the Administrative and Technical Services Agreement between Midnight and Daylight the Company relies significantly on Daylight and its employees in the conduct of its day-to-day business. To the extent Midnight or Daylight is not the operator of Midnight's oil and gas properties, Midnight will be dependent on such third party operators for the timing of activities related to such properties and will largely be unable to direct or control the activities of the operators. In addition, the success of Midnight will be largely dependent upon the performance of its management and key employees. Midnight does not have any key man insurance policies, and therefore there is a risk that the death or departure of any member of management or any key employee could have a material adverse effect on Midnight.

Changes in Legislation

The return on an investment in securities of Midnight is subject to changes in Canadian federal and provincial tax laws and government incentive programs and there can be no assurance that such laws or programs will not be changed in a manner that adversely affects Midnight or the holding and disposing of the securities of Midnight.

Seasonality

The level of activity in the Canadian oil and gas industry is influenced by seasonal weather patterns. Wet weather and spring thaw may make the ground unstable. Consequently, municipalities and provincial transportation departments enforce road bans that restrict the movement of rigs and other heavy equipment, thereby reducing activity levels. Also, certain oil and gas producing areas are

located in areas that are inaccessible other than during the winter months because the ground surrounding the sites in these areas consists of swampy terrain. Seasonal factors and unexpected weather patterns may lead to declines in exploration and production activity and corresponding declines in the demand for the goods and services of Midnight.

Assessments of Value of Acquisitions

Acquisitions of oil and gas issuers and oil and gas assets are typically based on engineering and economic assessments made by independent engineers and Midnight's own assessments. These assessments both will include a series of assumptions regarding such factors as recoverability and marketability of oil and gas, future prices of oil and gas and operating costs, future capital expenditures and royalties and other government levies which will be imposed over the producing life of the reserves. Many of these factors are subject to change and are beyond Midnight's control. In particular, the prices of and markets for oil and natural gas products may change from those anticipated at the time of making such assessment. In addition, all such assessments involve a measure of geologic and engineering uncertainty which could result in lower production and reserves than anticipated. Initial assessments of acquisitions may be based on reports by a firm of independent engineers that are not the same as the firm that Midnight uses for its year end reserve evaluations. Because each of these firms may have different evaluation methods and approaches, these initial assessments may differ significantly from the assessments of the firm used by Midnight. Any such instance may offset the return on and value of the Midnight Shares.

Third Party Credit Risk

Midnight is or may be exposed to third party credit risk through its contractual arrangements with its current or future joint venture partners, marketers of its petroleum and natural gas production and other parties. In the event such entities fail to meet their contractual obligations to Midnight, such failures could have a material adverse effect on Midnight and its funds from operations.

CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005

MANAGEMENT'S RESPONSIBILITY STATEMENT

The consolidated financial statements of Midnight Oil Exploration Ltd. and all information in this report are the responsibility of management and have been approved by the Board of Directors. The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. The consolidated financial statements include amounts that are based on estimates, which have been objectively developed by management using all relevant information. All financial and operating data in this report is consistent with the information in the consolidated financial statements.

Midnight Oil Exploration Ltd. maintains appropriate systems of internal control to give reasonable assurance that transactions are appropriately authorized, assets are safeguarded from loss or misuse and financial records are properly maintained to provide reliable information for the preparation of financial statements. Midnight Oil Exploration Ltd. has effective disclosure controls and procedures to ensure timely and accurate disclosure of material information relating to the Company which complies with the current requirements of Canadian securities legislation.

KPMG LLP, an independent firm of chartered accountants, has been engaged to examine the financial statements and provide their auditor's report. Their report is presented with the consolidated financial statements.

The directors are responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Board carries out this responsibility principally through its Audit Committee. The Audit Committee is comprised entirely of outside directors and meets regularly with management and with the Company's external auditors to discuss the results of their audit examination and to review issues related thereto. The external auditors have full access to the Audit Committee with and without the presence of management. The Audit Committee reviews the consolidated financial statements and Management's Discussion and Analysis and recommends their approval to the Board of Directors.

Signed "Fred Woods"

Signed "Judy Stripling"

Fred Woods
President and CEO

Judy Stripling
Vice President Finance and CFO

Calgary, Alberta
March 15, 2006

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Midnight Oil Exploration Ltd. as at December 31, 2005 and 2004 and the consolidated statements of income and retained earnings and cash flows for the year ended December 31, 2005 and for the period from November 29, 2004 to December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the year ended December 31, 2005 and for the period from November 29, 2004 to December 31, 2004 in accordance with Canadian generally accepted accounting principles.

Signed "KPMG LLP"

Chartered Accountants

Calgary, Canada
March 15, 2006

MIDNIGHT OIL EXPLORATION LTD.

Consolidated Balance Sheets

As at December 31,

(000's)

	2005	2004
Assets		
Current assets:		
Cash and cash equivalents	\$ -	\$ 5,031
Accounts receivable	6,259	1,132
Deposits and prepaid expenses	80	-
	<u>6,339</u>	<u>6,163</u>
Future taxes (note 7)	-	145
Petroleum and natural gas assets (note 3)	104,832	35,812
	<hr/> <u>\$ 111,171</u>	<hr/> <u>\$ 42,120</u>
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 11,096	\$ 3,261
Long-term debt (note 4)	11,973	-
Future taxes (note 7)	229	-
Asset retirement obligations (note 5)	1,416	542
Shareholders' equity:		
Share capital (note 6)	84,262	38,240
Warrants (note 6)	42	47
Contributed surplus (note 6)	469	15
Retained earnings	1,684	15
	<u>86,457</u>	<u>38,317</u>
	<hr/> <u>\$ 111,171</u>	<hr/> <u>\$ 42,120</u>

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Signed *“Tom Medvedic”*

Signed *“Paul Moynihan”*

Director

Director

MIDNIGHT OIL EXPLORATION LTD.
Consolidated Statements of Income and Retained Earnings
Periods ended December 31,

(000's, except per share amounts)

	2005	2004
Revenues:		
Petroleum and natural gas sales	\$ 22,989	\$ 977
Royalties	(5,953)	(211)
Other income	211	12
	17,247	778
Expenses:		
Operating	3,697	249
Transportation	11	1
Interest	187	-
General and administration	1,202	126
Stock-based compensation	449	15
Depletion, depreciation and accretion	8,456	329
	14,002	720
Income before taxes	3,245	58
Taxes: (note 7)		
Capital	88	-
Future	1,488	43
	1,576	43
Net income	1,669	15
Retained earnings, beginning of period	15	-
Retained earnings, end of period	\$ 1,684	\$ 15
Income per share: (note 6)		
Basic	\$ 0.06	\$ 0.00
Diluted	\$ 0.06	\$ 0.00

See accompanying notes to consolidated financial statements.

MIDNIGHT OIL EXPLORATION LTD.
Consolidated Statements of Cash Flows

Periods ended December 31,

(000's)

	2005	2004
Cash provided by (used in):		
Operations:		
Net income	\$ 1,669	\$ 15
Items not involving cash:		
Depletion, depreciation and accretion	8,456	329
Stock-based compensation	449	15
Future taxes	1,488	43
Abandonment expenditures	(95)	(5)
Funds from operations	11,967	397
Changes in non-cash working capital	(4,697)	(551)
	<u>7,270</u>	<u>(154)</u>
Financing:		
Issue of common shares	48,000	7,000
Issue of warrants	-	47
Share issue costs	(3,092)	-
Increase in long-term debt	11,973	-
Debt assumed on conveyance of assets (note 2)	-	(2,000)
Changes in non-cash working capital	91	138
	<u>56,972</u>	<u>5,185</u>
Investments:		
Petroleum and natural gas additions	(28,841)	(2,680)
Property acquisition	(47,666)	-
Changes in non-cash working capital	7,234	2,680
	<u>(69,273)</u>	<u>-</u>
Changes in cash	(5,031)	5,031
Cash, beginning of period	5,031	-
Cash, end of period	\$ -	\$ 5,031
Taxes paid	\$ -	\$ -
Interest paid	\$ 154	\$ -

Cash is defined as cash and cash equivalents.

See accompanying notes to consolidated financial statements.

MIDNIGHT OIL EXPLORATION LTD.

Notes to Consolidated Financial Statements

For the year ended December 31, 2005 and the period ended December 31, 2004
(Tabular amounts are stated in thousands of dollars except share and per share amounts)

Nature of operations:

Midnight Oil Exploration Ltd. ("Midnight" or the "Company") was incorporated on September 10, 2004 and commenced operations on November 30, 2004 under a Plan of Arrangement entered into by Midnight Oil & Gas Ltd., Daylight Energy Trust ("Daylight"), Daylight Acquisition Corp. and Midnight ("Plan of Arrangement"). Under the Plan of Arrangement, Daylight Acquisition Corp. acquired all the issued and outstanding shares of Vintage Petroleum Canada, Inc ("Vintage") and Midnight Oil & Gas Ltd., with certain assets of Midnight Oil & Gas Ltd. and Vintage transferred to Midnight Oil Exploration Ltd. As a result, the comparative financial statements presented are for the period from November 29, 2004 to December 31, 2004.

The principal business of the Company is the exploration for, exploitation, development and production of oil and natural gas reserves. All activity is conducted in Western Canada and comprises a single business segment.

1. Significant accounting policies:

The consolidated financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and revenues and expenses during the reporting period. Actual results could differ from those estimated.

Specifically, the amounts recorded for depletion, depreciation and accretion of petroleum and natural gas assets and asset retirement obligations are based on estimates. The ceiling test is based on estimates of reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(a) Consolidation:

The consolidated financial statements include the accounts of Midnight Oil Exploration Ltd. and its wholly owned subsidiary, Midnight Oil Resources Ltd. All inter-company transactions and balances have been eliminated.

(b) Cash and cash equivalents:

Cash and cash equivalents are comprised of cash and all investments with a maturity date of three months or less.

(c) Petroleum and natural gas assets:

(i) Capitalized costs:

The Company follows the full cost method of accounting for petroleum and natural gas assets. Under this method, all costs related to the acquisition of, exploration for and development of petroleum and natural gas reserves are capitalized. These costs include land acquisition costs, geological and geophysical expenditures, rentals and other carrying charges on undeveloped properties, costs of drilling both productive and non-productive wells, oil and gas production equipment and facilities, asset retirement costs and administration expenses directly related to the acquisition, exploration and development

activities. Proceeds from the disposition of oil and natural gas properties are accounted for as a reduction of capitalized costs, with no gain or loss recognized, unless such disposition would result in a change greater than 20% in the depletion or depreciation.

(ii) Depletion and depreciation:

Depletion of petroleum and natural gas assets and depreciation of production equipment are calculated using the unit-of-production method, based on production volumes before royalties in relation to estimated proven reserves as determined by an independent petroleum engineering firm. Natural gas reserves and production are converted to equivalent barrels of oil based upon the relative energy content of six thousand cubic feet of gas to one barrel of oil.

The cost of acquisition and evaluation of unproved properties are initially excluded from the depletion calculation. A separate impairment test is performed on these assets to determine whether the carrying value exceeds the fair value. Any excess in carrying value over fair value is an impairment. When proved reserves are assigned or a property is considered to be impaired, the cost of the property or the amount of the impairment will be added to the capitalized costs for the calculation of depletion.

Other assets are depreciated on a declining balance basis at rates ranging from 20% to 35%.

(iii) Ceiling test:

Petroleum and natural gas assets are evaluated in each reporting period to determine that the carrying amount is recoverable and does not exceed the fair value of the properties.

The carrying amounts are assessed to be recoverable when the sum of the undiscounted cash flows expected from the production of proved reserves, the lower of cost and market of unproved properties and the cost of major development projects exceeds the carrying amount of the cost centre. When the carrying amount is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the cost centre exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves, the lower of cost and market of unproved properties and the cost of major development projects of the cost centre. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

(d) Asset retirement obligations:

The Company recognizes the asset retirement obligations for the future cost associated with removal, site restoration and asset retirement costs. The fair value of the liability for the Company's asset retirement obligation is recorded in the period in which it is incurred, discounted to its present value using the Company's credit adjusted risk-free interest rate and the corresponding amount recognized by increasing the carrying amount of petroleum and natural gas assets. The asset recorded is depleted on a unit of production basis over the life of the reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. Revisions to the estimated timing of cash flows or to the original estimated undiscounted cost could also result in an increase or decrease to the obligation. Actual costs incurred upon settlement of the retirement obligation are charged against the obligation to the extent of the liability recorded.

(e) Joint interest operations:

Substantially all of the Company's exploration, development and production activities related to oil and gas operations are conducted jointly with others and accordingly the accounts reflect only the Company's proportionate interest in such activities.

(f) Revenue recognition:

Revenue from the sale of petroleum and natural gas is recognized during the month when title passes to a third party.

(g) Income taxes:

The Company uses the liability method of tax allocation accounting. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and measured using the substantially enacted tax rates and laws that will be in effect when the differences are expected to reverse.

(h) Stock-based compensation plans:

The Company applies the fair value method for valuing stock option grants and warrants. Under this method, compensation cost attributable to all share options granted and warrants issued are measured at fair value at the grant and issuance date and expensed over the vesting period with a corresponding increase to contributed surplus. Upon the exercise of the stock options and warrants, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to share capital.

(i) Per share information:

Basic per share information is computed by dividing income by the weighted average number of common shares outstanding for the period. The treasury stock method is used to determine the diluted per share amounts, whereby any proceeds from the stock options, warrants or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period. The weighted average number of shares outstanding is then adjusted by the net change.

(j) Flow-through shares:

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through shares are renounced to investors in accordance with tax legislation. Future tax liabilities and share capital are adjusted by the estimated cost of the renounced tax deductions when the expenditures are renounced.

2. Transfer of assets and commencement of commercial operations:

Under the Plan of Arrangement certain assets of Midnight Oil & Gas Ltd. and Vintage were transferred to the Company. The Midnight Oil & Gas Ltd. shareholders along with the Daylight Energy Trust investors effectively received 0.50 of a voting share of the Company for every common share of Midnight Oil & Gas Ltd and for every Series U subscription of Daylight Energy Trust. At the time of the transaction, the entities were related and therefore the assets and liabilities of Midnight have been accounted for on a "continuity of interests" basis.

Net assets acquired:		
Petroleum and natural gas assets	\$ 33,456	
Future taxes	188	
Accounts receivable ⁽¹⁾	138	
Debt assumed on conveyance of assets	(2,000)	
Asset retirement obligations	(542)	
Net assets transferred and share capital issued	\$ 31,240	

(1) Options were transferred on the Plan of Arrangement and were exercised for proceeds of \$138,000.

Relationship with Daylight

An Administrative and Technical Services Agreement with Daylight Energy Trust ("Daylight") provides for the shared services required to manage Midnight's activities and govern the allocation of general and administration expenses between the entities. Under this agreement, Daylight receives payment for certain technical and administration services provided to Midnight on a cost recovery basis. The Administrative and Technical Service Agreement has no set termination date and will continue until terminated by either party upon three months prior written notice to the other party. Pursuant to the Administrative and Technical Services Agreement and for the year ended December 31, 2005 \$995,000 (\$110,000 for the period from November 29, 2004 to December 31, 2004) of fees were charged relating to general and administration activities and \$1,627,000 (\$99,000 for the period from November 29, 2004 to December 31, 2004) of fees were charged relating to capital expenditures.

As a result of this technical service arrangement, the majority of the Company's accounts receivable and accounts payable as at December 31, 2005 and 2004 are due from (to) Daylight.

3. Petroleum and natural gas assets:

	2005	2004
Cost	\$ 113,567	\$ 36,138
Accumulated depletion and depreciation	(8,735)	(326)
Balance, December 31	\$ 104,832	\$ 35,812

On November 29, 2005, Midnight closed a property acquisition for a purchase price of \$47,666,000. The acquisition had an effective date of October 1, 2005. As part of the acquisition, Midnight assumed asset retirement obligations of \$707,000. This acquisition was completed in connection with Daylight's acquisition of the outstanding shares of Tempest Energy Corp. which closed on November 30, 2005.

During the year ended 2005, the Company capitalized \$1,627,000 (\$99,000 for the period from November 29, 2004 to December 31, 2004), of general and administration expenses related to exploration and development activities.

The cost of unproven properties at December 31, 2005 of \$24,895,000 (\$14,542,000 at December 31, 2004) has been excluded from the depletion and depreciation calculation. Future development costs of proven reserves of \$9,911,000 (\$3,500,000 at December 31, 2004) have been included in the depletion and depreciation calculation.

At December 31, 2005, the Company applied a ceiling test to its petroleum and natural gas assets using expected future market prices of:

Benchmark Reference Price Forecast	2006	2007	2008	2009	2010	2011
WTI (\$US/bbl)	57.00	55.00	51.00	48.00	46.50	45.00
AECO (\$Cdn/mcf)	10.60	9.25	8.00	7.50	7.20	6.90

The pricing for 2012 is the same as 2011, after 2012 the change in future prices are escalated at 2% per year to the end of the reserve life.

4. Long-term debt:

Midnight has a revolving term credit facility available up to \$20.0 million with a Canadian chartered bank. The facility is available on a revolving basis until June 30, 2006. On June 30, 2006, at the Company's discretion, the facility is available on a non-revolving basis for a period of 366 days, at which time the facility would be due and payable. Alternatively, the facility may be extended for a further 364-day period at the request of the Company and subject to approval by the bank. The credit facility bears interest at the bank prime rate and is secured by a \$50 million first floating charge debenture and a general securities agreement. At December 31, 2005, \$11,973,000 was drawn on this facility. The effective interest rate for the bank debt was 4.2% for the year ended December 31, 2005. The \$20.0 million borrowing base is subject to a semi-annual and annual review by the bank.

5. Asset retirement obligations:

The Company's asset retirement obligations result from net ownership interests in petroleum and natural gas assets including well sites, gathering systems and processing facilities. The Company estimates the total undiscounted amount of cash flow required to settle its asset retirement obligations is approximately \$3,950,000 (\$1,627,000 at December 31, 2004) which will be incurred from 2006 to 2054. The majority of the costs will be incurred between 2010 and 2020. An inflation factor of 2% has been applied to the estimated asset retirement cost at December 31, 2005 and 2004. A credit-adjusted risk-free rate of 8% at December 31, 2005 and 2004 was used to calculate the fair value of the asset retirement obligations.

A reconciliation of the asset retirement obligations is provided below:

	2005	2004
Balance, beginning of period	\$ 542	\$ -
Transfer of assets through Plan of Arrangement (note 2)	-	542
Liabilities incurred	215	2
Acquired on property acquisition (note 3)	707	-
Liabilities settled	(95)	(5)
Accretion expense	47	3
Balance, December 31	\$ 1,416	\$ 542

6. Share capital:

(a) Authorized:

The authorized share capital consists of an unlimited number of common shares without par value.

(b) Issued and outstanding:

On November 29, 2004, prior to the completion of the Plan of Arrangement, Midnight completed a private placement of 4,666,666 common shares at a price of \$1.50 per share for gross proceeds of \$7 million.

On November 30, 2004 the common shares were consolidated on a two for one basis, all number of shares and warrants and per share amounts have been restated to reflect the consolidation.

	Number of Shares	Amount
Common shares:		
Issued on incorporation	1	\$ -
Issued pursuant to private placement	4,666,666	7,000
Issued pursuant to the Plan of Arrangement (note 2)	21,661,162	31,240
Balance, December 31, 2004	26,327,829	38,240
Issued pursuant to private placement	12,000,000	48,000
Share issue costs (net of tax of \$1,114)	-	(1,978)
 Balance, December 31, 2005	38,327,829	\$ 84,262

On November 30, 2005, the Company issued 12,000,000 Common Shares at a price of \$4.00 per share. The proceeds, net of share issue cost of \$3.1 million (\$2.0 million net of tax), were \$44.9 million.

(c) Per share amounts:

Per share amounts have been calculated on the weighted average number of shares outstanding. The weighted average shares outstanding for the year ended December 31, 2005 were 27,347,007 (25,650,919 for the period from November 29, 2004 to December 31, 2004). Diluted per share amounts are calculated based on the diluted weighted average number of shares outstanding. The diluted weighted average shares outstanding for the year ended December 31, 2005 were 27,695,819 (25,804,126 for the period from November 29, 2004 to December 31, 2004) due to the dilutive effect of warrants and stock options.

(d) Stock options:

The Corporation has reserved 2,581,670 common shares for granting under option to employees, directors and other persons who provide ongoing management or consulting services to the Corporation. Stock options are granted for a term up to five years and vest over three years from the date granted. The exercise price of each option equals the market price of the Corporation's common shares on the date of the grant.

There were no stock options granted as at December 31, 2004. The summary of stock option activity for the year ended December 31, 2005 is presented below:

	Number of options	Weighted average exercise price
Balance, December 31, 2004	-	\$ -
Granted	1,174,300	3.49
Cancelled	(74,500)	3.30
Balance, December 31, 2005	1,099,800	\$ 3.50

The following table summarizes information about the stock options outstanding at December 31, 2005:

Range of exercise price	Options Outstanding			Options Exercisable		
	Number outstanding	Weighted average exercise price	Weighted average remaining contractual life (years)	Number exercisable	Weighted average exercise price	
\$ 3.00-3.99	941,800	\$ 3.40	4.3	—	\$ —	—
\$ 4.00-4.99	158,000	4.13	4.9	—	—	—
	1,099,800	\$ 3.50	4.4	—	\$ —	—

(e) Warrants:

	Number of Warrants	Amount
Warrants:		
Issued pursuant to private placement	2,333,333	\$ 47
Balance, December 31, 2004	2,333,333	\$ 47
Cancelled	(250,000)	(5)
Balance, December 31, 2005	2,083,333	\$ 42

On November 29, 2004, Midnight issued warrants to officers, service providers and directors of the Company. Each warrant is exercisable into one common share of the Company at a price of \$3.00 per share. The warrants vest equally over three years and expire on November 29, 2008. One third of the warrants vested on November 29, 2005 with 694,444 warrants being exercisable at December 31, 2005.

(f) Stock-based compensation:

Midnight accounts for its stock-based compensation plan using the fair value method. Under this method, a compensation cost is charged over the vesting period for warrants and options granted to employees, officers, directors and other service providers.

Midnight has not incorporated an estimated forfeiture rate for stock options that will not vest, rather the Company accounts for actual forfeitures as they occur.

The fair value of options and warrants granted were estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions and resulting values:

	2005	2004
Weighted average fair value of options and warrants granted	\$ 1.31	\$ 0.23
Risk free interest	3.7%	4.2%
Estimated hold period prior to exercise	4 years	4 years
Expected volatility	40%	40%
Dividend per share	\$ 0.00	\$ 0.00

(g) Contributed surplus:

The following table reconciles Midnight's contributed surplus:

	2005	2004
Balance, beginning of period	\$ 15	\$ -
Stock-based compensation expense	449	15
Cancellation of warrants	5	-
Balance, December 31	\$ 469	\$ 15

7. Taxes:

The provision for taxes in the financial statement differs from the result that would have been obtained by applying the combined federal and provincial tax rate to the Company's income before taxes. The difference results from the following items:

	2005	2004
Income before taxes	\$ 3,245	\$ 58
Combined federal and provincial tax rate	37.6%	38.6%
Computed "expected" tax expense	\$ 1,221	\$ 22
Increase (decrease) in taxes resulting from:		
Non-deductible crown charges	1,263	55
Resource allowance	(980)	(39)
Stock-based compensation	168	5
Other	(152)	-
Effect of change in tax rate	(32)	-
Future taxes	1,488	43
Capital taxes	88	-
Taxes	\$ 1,576	\$ 43

The future tax liability (asset) at December 31 is comprised of the tax effect of temporary differences as follows:

	2005	2004
Petroleum and natural gas assets	\$ 1,847	\$ 43
Asset retirement obligations	(496)	(188)
Non-capital losses	(165)	-
Attributed Canadian Royalty Income	(91)	-
Share issue costs	(866)	-
Balance, December 31	\$ 229	\$ (145)

8. Risk management:

(a) Credit risk:

Portions of the Company's accounts receivable are with joint venture partners in the oil and gas industry and are subject to normal industry credit risks. Purchasers of the Company's oil and natural gas products are subject to an internal credit review designed to mitigate the risk of non-payment.

(b) Commodity price risk:

There were no financial instruments in place to manage commodity prices during the period ended December 31, 2005.

(c) Foreign currency:

While substantially all of the Company's sales are denominated in Canadian dollars, the market prices in Canada for oil and natural gas are impacted by changes in the exchange rate between the Canadian and United States dollar.

(d) Fair value of financial instruments:

Financial instruments comprise cash and cash equivalents, accounts receivable and accounts payable and accrued liabilities. The fair values of these financial instruments approximate their carrying amounts due to their short-term maturities. The Company's long-term debt bears interest at a floating market rate and accordingly the fair market value approximates the carrying value.

(e) Interest rate risk:

The Company is exposed to interest rate risk to the extent that changes in market interest rates will impact the Company's cash and cash equivalents that have a floating interest rate. The bank facility is also based on a floating interest rate. The Company had no interest rate swaps or hedges at December 31, 2005.

MIDNIGHT OIL EXPLORATION LTD.

Selected Quarterly and Annual Information

Financial (000's, except for per share amounts)	Q4	2005	Q3	Q2	Q1	2005 Year	2004 Q4 ⁽¹⁾
Petroleum and natural gas sales	\$ 8,772	\$ 5,997	\$ 5,050	\$ 3,170	\$ 22,989	\$ 977	
Royalties	2,172	1,678	1,401	702	5,953	211	
Operating expenses	1,044	902	969	782	3,697	249	
Transportation expenses	3	5	-	3	11	1	
Net backs	\$ 5,553	\$ 3,412	\$ 2,680	\$ 1,683	\$ 13,328	\$ 516	
General and administration	491	278	292	141	1,202	126	
Net interest (income)	(68)	58	4	(18)	(24)	(12)	
Abandonment expenditures	51	3	10	31	95	5	
Capital tax	88	-	-	-	88	-	
Funds from operations	\$ 4,991	\$ 3,073	\$ 2,374	\$ 1,529	\$ 11,967	\$ 397	
Per share – Basic	0.16	0.12	0.09	0.06	0.44	0.02	
– Diluted	0.16	0.12	0.09	0.06	0.43	0.02	
Net income	\$ 864	\$ 487	\$ 158	\$ 160	\$ 1,669	\$ 15	
Per share – Basic	0.03	0.02	0.01	0.01	0.06	0.00	
– Diluted	0.03	0.02	0.01	0.01	0.06	0.00	
Additions to capital assets	\$ 55,285	\$ 8,175	\$ 4,482	\$ 8,565	\$ 76,507	\$ 2,680	
Net debt	16,730	11,344	6,242	4,134	16,730	(2,902)	
Total assets	111,171	54,187	47,350	45,106	111,171	42,120	
Shares outstanding							
Basic	38,328	26,328	26,328	26,328	38,328	26,328	
Diluted	41,511	29,360	29,393	28,821	41,511	28,661	
Operations							
Average daily production							
Natural gas (mcf/d)	4,694	4,885	5,151	3,924	4,666	3,549	
NGLs & crude oil (bbls/d)	600	270	297	135	326	132	
Combined (boe/d)	1,382	1,084	1,156	788	1,104	723	
Average prices received							
Natural gas (\$/mcf)	\$ 11.73	\$ 9.70	\$ 7.62	\$ 6.92	\$ 9.07	\$ 7.00	
NGLs & crude oil (\$/bbl)	66.19	64.97	53.64	58.96	62.35	50.75	
Combined (\$/boe)	\$ 69.02	\$ 60.13	\$ 48.01	\$ 44.68	\$ 57.04	\$ 43.58	
Royalties	17.09	16.82	13.33	9.89	14.77	9.40	
Operating expenses	8.22	9.05	9.20	11.03	9.17	11.14	
Transportation expenses	0.03	0.05	-	0.04	0.03	-	
Netback received (\$/boe)	\$ 43.68	\$ 34.21	\$ 25.48	\$ 23.72	\$ 33.07	\$ 23.04	

(1) 2004 is for the period of November 29, 2004 to December 31, 2004 and therefore represents both the fourth quarter and the results for the period ended December 31, 2004.

CORPORATE INFORMATION

DIRECTORS

Paul E. Moynihan,

Chairman of the Board ^{1, 2, 3, 4}

Managing Director and Partner

Mustang Capital Partners Inc.

Calgary, Alberta

Jay D. Squiers ^{1, 2, 3, 4}

Managing Director

Fortress Investment Group LLC

Dallas, Texas

United States

Tom J. Medvedic ^{1, 2, 3, 4}

Vice President, Finance and Chief Financial Officer

Calfrac Well Services Ltd.

Calgary, Alberta

Frederick N. Woods

President and Chief Executive Officer

Midnight Oil Exploration Ltd.

Calgary, Alberta

Anthony M. Lambert

President and Chief Executive Officer

Daylight Energy Trust

Calgary, Alberta

Members of the following Committees

1 Audit

2 Compensation

3 Reserves

4 Corporate Governance

CORPORATE OFFICE

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OFFICERS

Frederick N. Woods

President and Chief Executive Officer

Judith A. Stripling

Vice-President, Finance and
Chief Financial Officer

Thomas F. Moslow

Vice-President, Exploration

W. Randy Ford

Vice-President, Operations

Andrew D. Weldon

Vice-President, Land

Chris von Vegesack

Corporate Secretary

Partner

Burnet, Duckworth & Palmer LLP

Calgary, Alberta

Banker

Canadian Imperial Bank
of Commerce
Calgary, Alberta

Legal Counsel

Burnet, Duckworth & Palmer LLP
Calgary, Alberta

Auditors

KPMG LLP
Chartered Accountants
Calgary, Alberta

Evaluation Engineers

GLJ Petroleum Consultants
Calgary, Alberta

Registrar and Transfer Agent

Valiant Trust Company
Calgary, Alberta

TSX Symbol: MOX

Abbreviations

/d	per day	rbboe	thousand barrels of oil equivalent
bbbl(s)	barrel(s)	mmboe	million barrels of oil equivalent
mbbls	thousand barrels	mmstb	million stock tank barrels of oil
mmmbbls	million barrels	ARTC	Alberta Royalty Tax Credit
mcf	thousand cubic feet	Cdn	Canadian
mmcf	million cubic feet	NGLs	natural gas liquids
bcf	billion cubic feet	WTI	West Texas Intermediate crude oil
boe	barrels of oil equivalent	US	United States

Boe means barrel of oil equivalent, using the conversion factor of 6 mcf of natural gas being equivalent to one barrel of oil. Boes may be misleading, particularly if used in isolation. A boe conversion ratio of 6 mcf is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.



MIDNIGHT

Oil Exploration Ltd.

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